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Mr. Gable:

Please find transmitted herewith a copy of "Helping Employees Invest Wisley" by Michael Keppler. A full citation was made in Paper No. 6. If you have any further questions or concerns please contact me at the phone number listed above.

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Helping employees invest wisely. (profit-sharing plans) (Financial Planning)

Ranfile, H. Kenneth; Keppler, Michael J.

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Abstract: A review of the profit-sharing scheme in Towers Perrin showed that changes could be made in the program to improve it. Effective long-term strategies were developed for employees. These included the following changes: offering investment choices in different asset class portfolios with distinct risk and return characters, selecting new investment managers for the different portfolios, offering mixed portfolios and rebalancing preselected portfolio mixes automatically.

Text:

Like other employers, Towers Perrin faces the challenge of encouraging employees to participate in the company's profit-sharing plan as an integral part of their retirement resources.

In 1992, the Towers Perrin board of directors appointed a task force made up of representatives from the human resource department and members of its benefits and finance committees to undertake a thorough review of the firm's employee profit-sharing plan, a defined-contribution plan.

During the fact-finding phase, the task force found that most plan participants--active employees, retirees and other inactives--were making conservative investment decisions. Approximately 60 percent of the plan's money was invested in the fixed income fund.

Generally, the task force determined that employees did not have a long-term view of the plan, nor did they appreciate the importance of the plan as a retirement resource. This attitude about the plan, which the task force felt was reflected in employees' investment choices, was also based on a general lack of understanding of the basics of choosing investments.

The initial review of plan design suggested that some positive changes could be made in the investment choices themselves. In addition, the task force found that plan governance procedures--though consistently applied--could be clarified and documented.

Time for change

Working in tandem with Towers Perrin consultants, the task force set clear objectives for implementing changes to the profit-sharing plan. They were to ensure maximum potential return on participants' investments, provide participants with clear investment choices and assistance in managing risk and designing appropriate investment strategies, and manage plan fees appropriately and effectively.

To achieve these goals, the task force decided to adjust the asset-mix strategy of the plan and then review and select appropriate investment managers and educate employees about the role of the plan and their investment choices. The resulting changes were well-received and understood

by employees at all levels.

Innovative investment strategy

The first step in the redesign process was to thoroughly review the investment choices offered through the plan. Towers Perrin asset consultants, who help identify effective long-term investment strategies for defined-benefit and defined-contribution pension plan assets, recommended that the task force consider an approach based on "efficient frontier optimization" technology. This approach identifies the mix of investments that provides the highest expected return at any given level of risk. To carry out this approach the asset consultants advised the following changes, which Towers Perrin implemented effective January 1, 1993:

- * Offer investment choices in different asset class portfolios with distinct risk and return characteristics. No changes were made in the fixed income portfolio, since it was redesigned in 1991. However, three new equity asset-class portfolios were introduced: Large Company Domestic Equities, Intermediate and Small Company Domestic Equities and International Equities. These portfolio choices replaced the Equity Growth, Equity Income and Social & Urban Funds.

- * Select new investment managers for each of the equity asset-class portfolios. Successful candidates were chosen unanimously after a thorough review by the task force. Managers were judged on a wide array of selection criteria, including investment approach and philosophy, investment methodologies, historical performance, and commitment to service and fees. Two investment managers were chosen for each of the three equity-asset classes to provide a balanced approach to investing these funds. Each of the plan's investment managers will be reviewed quarterly by Towers Perrin asset consultants. This periodic review allows the company to meet plan governance requirements and monitor performance standards.

- * Offer employees portfolio mixes to take advantage of professional investment strategies. Towers Perrin asset consultants assembled the basic asset-class building blocks into diversified portfolio mixes. Each mix is a modern, balanced investment fund combining equities that are expected to provide greater long-term returns with fixed income investments, which provide greater stability in value. To further manage the potential fluctuations in the mixes' values, investments in equities are diversified among the three new equity asset-class portfolios.

The plan offers the following five preselected portfolio mixes, which are designed to provide the optimal expected return at the level of risk involved:

- * Mix A is the most conservative, with fixed income investments predominating.

- * Mixes B, C and D are progressively more aggressive, with an increasing percentage of holdings invested in equities.

- * Mix E is a 100-percent equity choice, the most aggressive of the plan's mixes.

Participants who don't find a mix that fits their personal investment strategy can create their own portfolio from any of the plan's underlying asset classes, both fixed income investments and equities.

Exhibit 1 shows how the four asset classes and investment portfolio mixes compare with each other on the risk and return scale, and where the mixes fall. Exhibit 2 shows the percentage of fixed income and equity holdings in each of the mixes. Both exhibits were used in the employee communication materials.

- * Rebalance preselected portfolio mixes automatically. An advantage of the preselected mixes is that they will be automatically rebalanced to maintain the same combination of fixed income and equity investments within a range of tolerance. This keeps the investment mixes consistent with the preselected level of risk. It also helps employees avoid the risk of trying

to "time" the market. In fact, automatic rebalancing facilitates buying low and selling high on a systematic basis.

Rebalancing is not automatic for participants who create their own portfolios, although these participants can still transfer funds monthly in order to keep the appropriate percentage of their profit-sharing account invested in the asset classes of choice.

Additional plan changes

The task force analyzed and adopted three additional plan changes. First, a new trustee was selected based on service capabilities and fees as well as the ability to value and rebalance the portfolio mixes. Asset consultants helped define a strategy for transferring assets from the existing to the new investment managers in concert with the new trustee.

Second, the task force decided that future investment management and trustee fees, paid primarily by Towers Perrin in the past, would be paid directly from the four asset-class portfolios. The use of both active and passive management of the four asset classes is expected to produce returns that exceed specific benchmarks. The firm believes the higher returns will more than cover the fees involved and still result in improved net returns for participants. Administrative and record-keeping fees will continue to be paid by Towers Perrin.

Third, plan governance provisions on selecting and reviewing performance of fiduciaries, trustees, investment managers and administrators were clarified, along with documentation of the chain of responsibility for all governance decisions.

Educating participants

The human resource department worked with Towers Perrin communication consultants to help participants understand their new investment choices. The goals of the communication campaign were to

- * Provide meaningful information about investment basics so that participants could make educated decisions about how to invest in the plan.
- * Reinforce the primary objective of the profit-sharing plan as a means of saving and investing for long-term retirement needs.

The information provided to participants focused on helping them understand the need to save and invest effectively based on their own specific investment goals. The investment decision was communicated as a choice about how to balance risk and potential return--not simply as a choice among investment funds. The themes, Investing in Your Future and Making the Most of Your Money, were repeated throughout the various communication materials. To reach all participants, including retirees and inactive participants, the communication campaign incorporated a variety of media, such as

- * An initial announcement from human resources to local management to inform them of the changes and enlist their help in the communication process.

- * An announcement memo to participants briefly summarizing the key features of the asset classes and portfolio mixes and providing a schedule of upcoming communication activities.

- * Two articles in the firm's human resource magazine, InnerView. The first provides the background on the changes to the profit-sharing plan along with underlying investment basics and the second provides a perspective on retirement planning and a link to the profit-sharing plan.

- * A summary brochure identifying investment managers and including full descriptions of the preselected portfolio mixes.

- * Face-to-face meetings led by trained meeting leaders to answer questions about the new choices.

Implementing system changes

Once the new investment choices were defined, the firm implemented changes in the interactive telephone system and Towers Perrin's record-keeping AccountManager software for defined contributions.

Personalized election worksheets were generated to communicate existing account balances and individual profit-sharing allocations for 1992. This personalized information was sent to both active and retired and other inactive participants to help them make investment choices over a one-week period in early December. Confirmation forms verifying choices were mailed to participants before the January 1 effective date of the change.

Results

The new investment choices made by participants tell an interesting story. There was wide general acceptance of the preselected portfolio mixes. Active participants shifted toward a more aggressive investment strategy, consistent with a long-term investment approach. Only 5 percent of active participants elected a 100-percent fixed income portfolio, compared to 24 percent of active participants in 1992. Other observations of the choices made by active participants:

- * Among actives, three-quarters of participants in all age groups chose to invest in the preselected portfolio mixes; however, the older participants did elect the more conservative portfolio-mix choices.

- * Eighty percent of administrative staff chose preselected mixes (compared with about 76 percent of junior professional staff and 71 percent of senior professional staff) and selected the more conservative of the preselected mixes.

Feedback from participants and meeting leaders indicated a new appreciation of the need for a personal investment strategy. Also, many participants felt they were able to make informed decisions about investing and appreciated being able to take advantage of the fund manager's expertise and investment technology through automatic rebalancing of the mixes.

What's next?

The positive response to the design and communication of the new investment options was encouraging, providing concrete evidence that education makes a significant impact on the behavior of employees. Information on investment basics enabled employees to make long-term decisions about how to invest for the future. Towers Perrin plans to undertake a retirement-planning education program to help employees target how much they will need and how much they need to save on their own for retirement.

Additional communication activities will include the introduction of interactive software to help employees with retirement and investment planning, supplemented with continuing information about how to plan for financial security in retirement. In an ongoing effort to deliver benefits that are appropriate and that meet employees' ever-changing needs, the human resource department will continue to monitor the performance of the mixes and the investment managers with the help of Towers Perrin asset consultants.

Before Plan Redesign

- * Before 1992, the plan offered four investment choices. A fixed income fund (redesigned during 1991) offered investments in a mix of guaranteed investment contracts and intermediate and short-term bonds. Three equity funds--an equity growth fund, an equity income fund and a social and urban fund--offered participants the ability to invest more aggressively in diversified funds holding common stocks.

- * Towers Perrin's finance department administered the profit-sharing plan until 1991, when administration and record-keeping activities for all benefit plans were consolidated into the human resource department. With the shift, improvements in the interactive telephone and record-keeping systems allowed participants the convenience of monthly processing of fund transfers, withdrawals and loans.

- * Communication about the plan's investment options focused on basic

descriptions of the funds and the fund managers. To keep participants informed about their choices, investment reports showing current results and the historical experience of each of the investment funds were distributed annually. Participants received quarterly statements showing account balances and fund performance, and monthly performance results were also available through the interactive telephone system.

H. Kenneth Ranftle, SPHR, is managing director of human resources for Towers Perrin in Valhalla, N.Y. He serves on SHRM's board of directors as a vice-president-at-large.

Michael J. Keppler is director of compensation and benefits at Towers Perrin and a consultant specializing in total compensation issues.

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